



U.S.-CHINA ECONOMIC AND SECURITY
REVIEW COMMISSION

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**U.S. – CHINA COMMISSION CITES TROUBLING TRENDS FOR
U.S. ECONOMIC AND NATIONAL SECURITY INTERESTS**

*Details Year-Long Studies and Offers Numerous Recommendations
In Annual Report to Congress*

WASHINGTON, DC (June 15, 2004) – The U.S.-China Economic and Security Review Commission (Commission), a bipartisan Commission established by Congress in 2000 to investigate, analyze and provide recommendations to Congress on the economic and national security implications of the U.S.–China relationship, today announced the release of its 2004 Annual Report to Congress (Report). Based on its extensive series of hearings and research, the Report concludes that: “*a number of the current trends in U.S.–China relations have negative implications for our long-term economic and national security interests, and therefore that U.S. policies in these areas are in need of urgent attention and course corrections.*”

“U.S.-China relations have become increasing complex, touching on vital areas of both U.S. economic and national security,” said Commission Chairman, Roger W. Robinson, Jr. “In our report to Congress, we have attempted to identify the key intersections of our vast economic relationship with China, the economic health of our country, and the security challenges we face from China’s growing political, economic, and military prominence in Asia. Properly managing this relationship will be an essential twenty-first century undertaking for the United States”

“Our report details a number of areas where U.S.-China relations have not developed in a manner the benefits our nation’s long-term interests,” said Commission Vice Chairman, C. Richard D’Amato. “We believe, however, that with a more coordinated, better managed approach to our relations with China, accompanied by the firm use of the significant economic and political leverage the United States can bring to bear, we can move U.S.-China relations in a positive direction.”

Congress gave the Commission the overarching mission of evaluating on an annual basis “the national security implications of the bilateral trade and economic relationship between the United States and the People’s Republic of China.” Within this context, it directed the Commission specifically to investigate the following areas: China’s proliferation practices, China’s economic reforms and U.S. economic transfers to China, China’s energy needs, Chinese firms’ access to the U.S. capital markets, U.S. investments into China, China’s economic and security impacts in Asia, U.S.-China bilateral programs and agreements, China’s record of compliance with its World Trade Organization (WTO) commitments, and the Chinese government’s media control efforts.

The Report presents its key findings, analysis, and recommendations to Congress in each of these areas. A synopsis of the Report and a sampling of the Commission's key findings and recommendations follow. The full Report is available on the Commission's Web site (www.uscc.gov).

U.S.-China Trade and Economic Transfers

Bilateral trade and investment flows between the United States and China are taking place on a massive and rapidly increasing scale. U.S.-China trade reached \$181 billion in 2003, highlighted by a U.S. goods trade deficit with China that escalated to \$124 billion, a 20 percent increase over 2002. It is the United States' most lopsided trade relationship, with U.S. imports from China (\$152 billion) outpacing exports to China (\$28 billion) by more than 5 to 1. The goods involved range from consumer items to advanced technology products. At the same time, U.S. firms continue to invest heavily in China, moving manufacturing capacity and, in some cases, research and development along with this investment. In addition, an increasing number of Chinese firms – predominately state-owned enterprises – are listing on global capital markets, including those of the United States, and attracting billions of dollars from U.S. investors with little disclosure or transparency as to the finances or operations of these firms. Assessing how all of these flows affect the U.S. economy, U.S. economic security, and broader U.S. security interests is an essential area of the Commission's work.

Key Findings:

- *The U.S. trade deficit with China is of major concern because (i) it has contributed to the erosion of manufacturing jobs and jobless recovery in the United States, (ii) manufacturing is critical for the nation's economic and national security, and (iii) the deficit has adversely impacted other sectors of the U.S. economy as well. .*
- *Though China has made progress in reducing tariffs and otherwise formally meeting a large number of its WTO accession commitments, significant compliance shortfalls persist in a number of key areas for U.S. trade. Among areas of concern are China's manipulation of its currency, continued provision of direct and indirect subsidies to Chinese producers, use of unjustified technical and safety standards to exclude foreign products, poor enforcement of intellectual property rights (IPR), and discriminatory tax treatment for domestic semiconductor production. Moreover, China has deliberately frustrated the effectiveness and debased the value of the WTO's Transitional Review Mechanism (TRM), which was intended to be a robust mechanism for assessing China's WTO compliance and for placing multilateral pressure on China to address compliance shortfalls.*
- *Without adequate information about Chinese firms trading in international capital markets, U.S. investors may be unwittingly pouring money into black box firms lacking basic corporate governance structures, as well as enterprises involved in activities harmful to U.S. security interests.*

Recommendations:

- *In the absence of concrete progress by the administration in moving China toward a substantial upward revaluation of the yuan against the dollar and to repegging the yuan to a trade-weighted basket of currencies, Congress should pursue legislative measures that will direct the administration to take action – through the WTO or otherwise – to combat China's exchange rate practices*
- *Congress should direct the United States Trade Representative (USTR) and the Department of Commerce to undertake immediately a comprehensive investigation of China's system of government subsidies for manufacturing, including tax incentives, preferential access to credit and capital from state-owned financial institutions, subsidized utilities, and investment*

conditions requiring technology transfers. USTR and Commerce should provide the results of this investigation in a report to Congress that assesses whether any of these practices may be actionable subsidies under the WTO and lays out specific steps the U.S. government can take to address these practices.

- *Congress should press the administration to make more use of the WTO dispute settlement mechanism and/or U.S. trade laws to redress unfair Chinese trade practices. In particular, the administration should act promptly to address China's exchange rate manipulation, denial of trading and distribution rights, lack of IPR protection, objectionable labor standards, and subsidies to export industries.*

- *If China continues to frustrate the TRM process, the U.S. government should work with the European Union, Japan, and other major trading partners to produce a separate, unified annual report that measures and reports on China's progress toward compliance and coordinates a plan of action to address shortcomings.*

- *Congress should bar U.S. institutional or private investors from making debt or equity investments, directly or indirectly, in firms identified and sanctioned by the U.S. government for weapons proliferation-related activities, whether they are listed and traded in the United States or in the Chinese or other international capital markets.*

Regional and Geostrategic Developments

The Commission examined China's rise as a regional power, its central role in the global security challenges stemming from the proliferation of weapons of mass destruction (WMD) and ballistic missiles, and its growing impact on energy markets. In assessing these issues, the Commission weighed the extent to which China is contributing to or undermining a more stable global security environment. China's enhanced diplomatic efforts with its regional neighbors contrasts with its hard-line actions relating to democratic developments in Hong Kong and Taiwan. Its intermediary role in the North Korea nuclear crisis will be a major test of U.S.-China relations. China's growing energy needs and dependency on imported oil is driving it to pursue energy policies that may undermine U.S. energy and security interests. Each of these developments poses serious challenges to U.S. policies.

Key Findings

- *While China has undertaken a diplomatic offensive in Asia to reassure its neighbors of its long-term peaceful intentions, buying time and space in the process to pursue its economic development and military strengthening, countries in the region appear to perceive the United States as losing focus on Asia as it prosecutes the war on terrorism.*

- *China's recent actions toward Taiwan and Hong Kong call into question its commitments to a peaceful approach toward Taiwan and to preserving Hong Kong's autonomy and self-government. These developments merit a fresh look at U.S. policies in these areas by the Congress and executive branch. In particular, recent developments across the Strait are putting increasing stress on the United States' one China policy, demonstrating the need for a new assessment of this policy that takes into consideration current realities.*

- *The United States has placed great faith in China's ability to move North Korea toward renouncing its nuclear weapons programs. The U.S.-China working relationship to defuse this crisis has been lauded as an essential component in bilateral relations, one that appears to trump other areas of U.S. concern. The Commission believes China has not effectively utilized its substantial leverage over North Korea to produce a workable resolution and regards China's performance in this regard over the next few months as a key test of the U.S.-China relationship.*

- *China's growing energy needs, linked to its rapidly expanding economy, are creating economic and security concerns for the United States. China's energy security policies are driving it into bilateral arrangements that undermine multilateral efforts to stabilize oil supplies and prices, and in some cases may involve dangerous weapons transfers.*

Recommendations

- *Congress should revitalize U.S. engagement with China's Asian neighbors by encouraging U.S. diplomatic efforts to identify and pursue initiatives to demonstrate the United States' firm commitment to facilitating the economic and security needs of the region.*
- *Congress should consult with the administration to assess jointly whether the PRC's recent interventions impacting Hong Kong's autonomy constitute grounds for invoking the terms of the U.S.-Hong Kong Policy Act with regard to Hong Kong's separate treatment. Congress and the administration should continue to keep Hong Kong issues on the U.S.-PRC bilateral agenda and work closely with the United Kingdom on Hong Kong issues.*
- *Congress and the administration should conduct a fresh assessment of the one China policy, given the changing realities in China and Taiwan, including the policy's successes, failures, and continued viability; whether changes may be needed in the way the United States government coordinates its defense assistance to Taiwan; and how U.S. policy can better support Taiwan's breaking out of the international economic isolation that the PRC seeks to impose on it.*
- *Congress should consult with the administration on developing appropriate ways for the United States to facilitate actively cross-Strait dialogue that could promote the long-term, peaceful resolution of differences between the two sides and could lead to direct trade and transport links and/or other cross-Strait confidence-building measures. The administration should be directed to report to Congress on the status of cross-Strait dialogue, the current obstacles to such dialogue, and, if appropriate, efforts that the United States could undertake to promote such a dialogue.*
- *Congress should press the administration to work with its regional partners, intensify its diplomacy, and ascertain North Korean and Chinese intentions with a detailed and staged proposal beginning with a freeze of all North Korea's nuclear weapons programs, followed by a verifiable and irreversible dismantlement of those programs.*
- *Congress should direct the secretaries of State and Energy to consult with the International Energy Agency with the objective of upgrading the current loose experience-sharing arrangement, whereby China engages in some limited exchanges with the organization, to more structured arrangement whereby the PRC would be obligated to develop a meaningful strategic reserve, and coordinate release of stocks in supply disruption crises or speculator-driven price spikes.*

Technology and Military Advancements

China has rapidly advanced in technology development, military modernization, and media control. These advances are altering bilateral and regional trade flows, the cross-Strait military balance, and the Chinese government's ability to control the media and shape perceptions of the United States and its policies.

Key Findings:

- *China's development as a locus of high-technology manufacturing and R&D has been a key component of its economic reform strategy, and the pace of this development has exceeded many outside observers' expectations. What China does with its growing technology capabilities – whether it converts them to military uses and/or to control the free flow of information to its population – is of direct national security concern to the United States. Moreover, the extent to which these advances allow China to challenge U.S. competitiveness in technology development is a vital matter for U.S. economic security. .*
- *China's quantitative and qualitative military advancements have resulted in a dramatic shift in the cross-Strait military balance toward China, with serious implications for Taiwan, for the United States, and for cross-Strait relations.*
- *There has in practice been no fundamental change in the Chinese government's approach to controlling the media, including information available through the Internet. This control shapes the Chinese population's perceptions of the United States and its policies,*

enhancing the risk of misperception and miscalculation in the bilateral relationship and increasing the potential for, and the difficulty of, managing crisis situations.

Recommendations:

- *Congress should direct the administration to develop and publish a coordinated, comprehensive national policy and strategy designed to meet China's challenge to the maintenance of our scientific and technological leadership and competitiveness in the same way it is presently required to develop and publish a national security strategy.*
- *Congress should urge the President and the secretaries of State and Defense to press strongly their European Union counterparts to maintain the EU arms embargo on China.*
- *Congress should direct the administration to restrict foreign defense contractors who sell sensitive military-use technology or weapons systems to China from participating in U.S. defense-related cooperative research, development, and production programs, which restriction can be targeted to cover only those technology areas involved in the transfer to China, and to provide a comprehensive annual report to the appropriate committees of Congress on the nature and scope of foreign military sales to China, particularly from Russia and Israel.*
- *Congress should enhance funding for the Broadcasting Board of Governors' programs aimed at circumventing China's Internet firewall through the development of anticensorship technologies and methods, and direct the Department of Commerce and other relevant agencies to conduct a review of export administration regulations to determine whether restrictions are needed on the export of U.S. equipment, software, and technologies that permit the Chinese government to surveil its own people or censor free speech.*

More information about the Commission, as well as its prior reports, hearing transcripts, and research products are available on the Commission's Web site (www.uscc.gov).

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